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BEFORE THE ARIZONA CORPORATION COMMISSION

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**WILLIAM A. MUNDELL**  
Chairman

**JIM IRVIN**

Commissioner

**MARC SPITZER**

Commissioner

Arizona Corporation Commission

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AZ CORP COMMISSION  
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**IN THE MATTER OF U S WEST  
COMMUNICATIONS, INC.'S**

**COMPLIANCE WITH SECTION 271 OF THE  
TELECOMMUNICATIONS ACT OF 1996**

) **DOCKET NO. T-00000A-97-0238**

)

) **AT&T'S FILING TO**

) **SUPPLEMENT ITS MOTION**

) **TO REOPEN AND**

) **SUPPLEMENT THE RECORD**

AT&T Communications of the Mountain States, Inc. and TCG Phoenix (collectively "AT&T") hereby supplement AT&T's Motion to Reopen and Supplement the Record on Qwest's Compliance with Section 272 of the Telecommunications Act of 1996.

On September 26, 2002, AT&T filed a Motion to reopen and supplement the record based on Qwest's decision to create a new section 272 affiliate to demonstrate compliance with section 272. Qwest opposed AT&T's Motion. Staff supported it. Oral arguments on AT&T's Motion were heard November 4, 2002. A ruling on AT&T's Motion has not been made. AT&T believes that recent events are relevant to AT&T's Motion. Therefore, AT&T provides additional information supporting its Motion.

On November 22, 2002, KPMG LLP filed an *ex parte* with the Federal Communications Commission ("FCC") stating that an "Independent Accountants' Report" dated September 4, 2002, and filed in Qwest's FCC Section 271 proceedings "should no longer be relied upon." See Attachment A.

On December 4, 2002, AT&T filed an *ex parte* with the FCC in WC Docket No. 02-314 that responds to the November 22 *ex parte* letter filed by KMPG LLP.

See Attachment B.

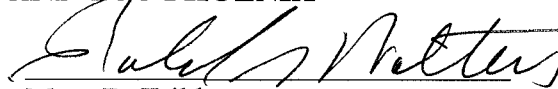
Qwest has argued that, despite the fact that neither Qwest Corporation ("Qwest"), the Bell operating company, and Qwest Communications Corporation ("QCC"), the section 272 affiliate, could certify compliance with generally accepted accounting principles ("GAAP"), Qwest and QCC were nonetheless accounting for transactions with each other in conformity with GAAP. See Qwest's Opposition to AT&T's Motion at 6. However, as a result of KPMG's retraction, even transactions between Qwest and its 272 affiliates are in doubt, and the only evidence offered by Qwest to show compliance with section 272(c)(2) is the bare assertion of Qwest's own employee, Ms. Marie E. Schwartz. This testimony is suspect based on Mr. Oren G. Shaffer's August 20, 2002, *ex parte*. See AT&T's Motion at 3-4. As AT&T concludes in its *ex parte*, Qwest cannot demonstrate that either QCC, its prior section 272 affiliate, or Qwest Long Distance Corporation ("QLDC"), its new section 272 affiliate, comply with section 272.

The two *ex partes* lead further support to AT&T's Motion.

Therefore, AT&T respectfully requests that the Commission consider this filing and attachments in rendering its decision on AT&T's Motion and further requests that AT&T's Motion be granted.

Dated this 6<sup>th</sup> day of December, 2002.

**AT&T COMMUNICATIONS OF  
THE MOUNTAIN STATES, INC.  
AND TCG PHOENIX**



Mary B. Tribby  
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ATTACHMENT A

November 22, 2002

EX PARTE

Ms. Marlene Dortch  
Secretary  
Federal Communications Commission  
445 Twelfth Street, S.W.  
Washington, D.C. 20554

Re: WC Docket No. 02-314 - Application of Qwest Communications International Inc. for  
Authorization to Provide In-Region, InterLATA Service in the States of Colorado, Idaho, Iowa,  
Montana, Nebraska, North Dakota, Utah, Washington, and Wyoming

Dear Ms. Dortch:

Please include the attached letter from KPMG LLP dated November 22, 2002, in the record for FCC WC  
Docket No. 02-314.

If you have any questions feel free to call Jim Bickell, Partner, KPMG Denver Office at (650) 302-4221.

Respectfully submitted,

**KPMG LLP**

Cc: Bill Johnston  
Mark Stephens (FCC)

November 22, 2002

To the Management of  
Qwest Communications International Inc. and the Federal  
Communications Commission:

KPMG LLP issued a report entitled "Independent Accountants' Report" to the management of Qwest Communications International Inc. and the Federal Communications Commission (FCC), dated September 4, 2002. This report refers to a review of management's assertion regarding the evaluation of certain accounting transactions identified by Qwest Communications International Inc. and the determination that such accounting transactions are not direct affiliate transactions between Qwest Corporation (QC) and Qwest Communications Corporation (QCC), or are direct affiliate transactions between QC and QCC and have been accounted for in accordance with C.F.R. Section 32.27. The accountants' report indicates that the review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. We understand that on September 4, 2002 this report was included in FCC WC Docket No.'s 02-148 and 02-189, (the only dockets in which QCC was designated as the 272 subsidiary) relating to Qwest's 271 applications. We also understand that both dockets have been terminated. In addition, we understand that this report was incorporated by reference into FCC WC Docket No. 02-314 on September 30, 2002.

Subsequent to issuance of the accountants' report, we determined that the standards referred to above do not provide for the provision of a review-level service in these instances. For that reason, KPMG LLP hereby advises you that the aforementioned accountants' report is no longer to be relied upon by any party effective with the date of this letter.

We request that Qwest Communications International Inc. and the Federal Communications Commission advise those parties that have received a copy of KPMG LLP's accountants' report dated September 4, 2002, and which you believe are relying on – or are likely to rely on – management's assertion and the related accountants' report, of our notification to you that the accountants' report should no longer be relied upon.

Please acknowledge receipt of this letter by signing and returning the duplicate to KPMG LLP.

**KPMG LLP**

Cc: Bill Johnston  
Mark Stephens (Federal Communications Commission)

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**Acknowledged**

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**Date**

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December 4, 2002

Marlene Dortch  
Secretary  
Federal Communications Commission  
445 12th Street, NW  
Washington, DC 20554

Re: *Consolidated Application for Authority to Provide In-Region, InterLATA Services in Colorado, Idaho, Iowa, Nebraska, North Dakota, Montana, Utah, Washington, and Wyoming, WC Docket No. 02-134*

Dear Ms. Dortch:

This letter responds to the November 22, 2002 *ex parte* letter filed by KPMG LLP in the above-captioned proceeding. The purpose of the KPMG letter was to inform the Commission that a previous submission by KPMG to the Commission concerning Qwest's compliance with section 272(b)(2) and 272 (c)(2) of the Communications Act is withdrawn and can no "longer be relied upon." This astonishing development confirms beyond doubt that Qwest's application must be denied, because Qwest has not, and could not, meet its obligation under 47 U.S.C. § 271(d)(3)(B) to demonstrate its compliance with the critically important accounting safeguards of section 272.

Specifically, in the prior Qwest 271 proceedings, Qwest argued that, despite the fact that neither Qwest Corp. ("QC"), Qwest's Bell Operating Company, nor Qwest Communications Corp. ("QCC"), Qwest's section 272 affiliate, could certify compliance with generally accepted accounting principles ("GAAP"), QC and QCC were nonetheless accounting for transactions with each other in conformity with GAAP. To support this contention, Qwest submitted a September 4, 2002 letter from KPMG. In that statement, KPMG purported to "review" Qwest's representation regarding its ongoing accounting investigation. According to Qwest, it had as of August 19, 2002, identified 42 potential accounting violations, and the only one that pertained to a BOC-272 affiliate transaction had been resolved. Based on its "review," KPMG attested that "nothing came to our conclusion that caused us to believe that management's assertions" were incorrect. AT&T demonstrated in the prior proceedings that KPMG's "review" opinion was entitled to no weight because it did nothing more than accept Qwest's representations about potential restatement items and did not independently examine the

Marlene Dortch  
November 26, 2002  
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underlying transactions between QC and the 272 affiliate in order to ensure that those transactions were being properly recorded by QC

In the current proceeding, Qwest nonetheless incorporated the KPMG statement by reference and again argued that QC is accounting for transactions with the 272 affiliate (now Qwest Long Distance Corporation ("QLDC")) in conformity with GAAP, despite QC's ongoing inability to certify its books. By way of its November 22 letter, however, KPMG has acknowledged that its prior conclusions must be retracted and should be accorded no weight in this proceeding. KPMG provides no explanation why it has withdrawn its prior statement, other than to state cryptically that "in these instances" a "review-level service" was inappropriate. The Commission must therefore assume that KPMG has subsequently discovered information that caused it to reverse its prior conclusions about the propriety of QC's accounting for transactions with the 272 affiliate. But whatever the reason for KPMG's action, there is now plainly no basis for any reasoned Commission finding that Qwest has demonstrated compliance with the section 272 accounting safeguards.

As a result of KPMG's retraction, the only "evidence" offered by Qwest to show its compliance with section 272(c)(2) is the bare assertion of its own employee, Ms. Schwartz, that "[t]he accounting policies and practices that give rise to QC's inability to certify its financial statements have been revised such that instances of material noncompliance with GAAP are not continuing and further do not affect GAAP compliance for transactions between QC and QLDC."<sup>1</sup> But in the absence of any factual support, her *ipsi dixit* simply cannot be credited. Qwest has provided no evidence of any independent examination of Qwest's accounting policies, practices and internal controls to support that bare assertion. Moreover, in both the Qwest I and Qwest II proceedings, Ms. Schwartz opined that QC "follows Generally Accepted Accounting Principles,"<sup>2</sup> – a statement that Qwest never retracted even after it was clear that it was not true.<sup>3</sup> In all events, as Professor Holder has explained, it is well established in the accounting profession that mere management representations are patently inadequate support for any reasoned finding of GAAP compliance. Qwest proffers no expert testimony to rebut Professor

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<sup>1</sup> Qwest III, Schwartz Reply Dec. ¶ 7.

<sup>2</sup> See Qwest I, Schwartz Dec. ¶ 48; Qwest II, Schwartz Dec. ¶ 47.

<sup>3</sup> Compare Qwest I & II, *Ex Parte* Letter from Peter A. Rohrbach to Marlene Dortch (August 27, 2002) (attaching revised Brunsting and Schwartz Declarations that continued to state unqualifiedly that QCC and QC "follow[] Generally Accepted Accounting Principles") with Qwest I & II, *Ex Parte* Letter from Oren Shaffer to Marlene Dortch, at 1 (August 20, 2002) ("QCII's internal investigations have now identified, with respect to the QC and QCC financial statements, (1) accounting transactions for QCC that did not comply with the requirements of GAAP, and (2) certain potential adjustments to the financial statements of QC that may be necessary to comply with GAAP.")

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Holder, and it is now clear that the Commission can expect no rebuttal from KPMG, the accounting firm that is actually conducting the investigation of Qwest's concededly flawed accounting policies and concededly inadequate internal controls.<sup>4</sup>

Thus, in light of the evidence of record, only one conclusion could withstand appellate review – that Qwest does not satisfy section 272(c)(2). As Professor Holder has testified, Qwest's filings with the SEC establish that: i) Qwest's accounting policies themselves are under investigation; ii) Qwest has a history of pervasive and systemic non-compliance with GAAP; and iii) Qwest's internal investigation is ongoing and the full extent of Qwest's problems is still not known. Indeed, since it filed its latest section 271 application, Qwest has been forced to acknowledge that its accounting problems go well beyond mere capacity swaps, that it has begun investigating "routine" transactions, that its review of its internal accounting controls is incomplete, and that the new controls have not been adequately reviewed and tested by KPMG.<sup>5</sup> Given these undisputed facts, there can be no grounds for crediting the mere assertion that QC is now complying with GAAP with regard to transactions with Qwest's 272 affiliate.<sup>6</sup> To the contrary, as Professor Holder concludes, "before there can be any reasonable assurance that QLDC and QC will be able to produce financial information that complies with GAAP in the immediate future, Qwest should finish its investigation, establish and test the functioning of adequate controls, and provide sufficient evidence of GAAP-compliance that goes beyond mere representations."<sup>7</sup>

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<sup>4</sup> See Qwest III, *Ex Parte* Letter from C. Frederick Beckner III to Marlene Dortch (Nov. 7, 2002) (attaching Declaration of William Holder ("Holder *Ex Parte* Dec.")).

<sup>5</sup> See generally Qwest November 14, 2002 8-K. In this regard, Qwest has acknowledged that effective internal controls are a pre-condition to finding compliance with section 272. Qwest III Reply at 14 ("The relevant question is whether a Section 272 affiliate has implemented internal control mechanisms reasonably designed to prevent, as well as detect and correct, any noncompliance with section 272.").

<sup>6</sup> See Holder *Ex Parte* Dec. ¶¶ 21-27.

<sup>7</sup> *Id.* ¶ 22. In addition, as AT&T has explained in its prior filings on this issue, Qwest cannot satisfy section 272 without proffering hard evidence that QCC – the entity which Qwest concedes will eventually become its 272 affiliate – complies with the section 272 accounting requirements.

Marlene Dortch  
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Sincerely

C. Frederick Beckner III



## **CERTIFICATE OF SERVICE**

I certify that the original and 13 copies of AT&T's Filing to Supplement Its Motion to Reopen and Supplement the Record in Docket No. T-00000A-97-0238 were sent by overnight delivery on December 6, 2002 to:

Arizona Corporation Commission  
Docket Control – Utilities Division  
1200 West Washington Street  
Phoenix, AZ 85007

and a true and correct copy was sent by overnight delivery on December 6, 2002 to:

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